TESTIMONY OF DARRELL K. FENNELL
in support of S.B. 4
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A. **Rents are at Historical Highs in Connecticut and Continue to Rise without Restraint**

Testimony from the hearing on HB 6588 established beyond a doubt that rents in this state for so-called "affordable housing" is at an all time high. And more worryingly, the rate of increase since at least 2019 have made those rents rise astronomically. The Connecticut Mirror (2/21/23) cites industry sources to conclude:

> "Rents have risen in Connecticut over the past year and since the pandemic began. In Hartford, data from Apartment List show that rents have risen by more than 17% since March 2020. In New Haven, the increase is listed at nearly 11%, and many tenants have reported much higher increases."

And testimony last week showed how much higher, and how it was often done in retaliation or for retribution. One Middletown senior tenant, for example, submitted written testimony showing that in three years his rent had increased 43.5%. There was also testimony of negative rent increases in the form of reduction in service and habitability of the premises.

Landlords generally attributed the rate increases to the pandemic. But no one explained what about the pandemic caused them to increase rent. There was no uptick in inflation, none said that additional services were required; in fact, it seems that they provided fewer. The conclusion can be inferred: landlords increased the rent because they could. Fear and absence of alternatives made the tenants easy to squeeze, and the landlords did so.

The fact is that landlords knew even before the pandemic that rents were at historic highs. In fact, Up Realty LLC, a Brooklyn-based property manager affiliated with out-of-state investment funds that have greatly increased their ownership of Connecticut rental properties. In its Linked in profile, which was aimed at investors, certainly not tenants, written before the end of 2019, Up Realty said it point blank:

> "With interest rates @ 50 year lows, building at low multiples off RR, and **Rents STILL all-time highs**, it is an opportune time to acquire additional properties." [Emphasis added.]

B. Uncontrolled Rent Increases Have Not Increased Newly Constructed Rental Stock.

If increased rent acted as a price signal to draw in new construction of rental stock, there would be a building boom long before now. But the fact is that construction has seriously lagged for the past half century. As a result the rental stock is drastically constrained. One key indicator makes that apparent: According to the U.S. Census Bureau, as of the second quarter of 2022, Connecticut's rental vacancy rate was 2.1% overall. Along the "Stamford-New Haven corridor had a vacancy rate below 1.5 percent, trailing only a few metropolitan regions for the lowest in the nation." (*See CT Insider*, 8/25/22.) And this is the vacancy rate in all apartments. The testimony shows that for "affordable housing" the supply is even more deficient. You can look at the reviews of the few constructions taking place, and see that "affordable housing" is only a small fraction of what is being built. In fact, rental units that would accommodate a family of more than one child is nearly is nearly invisible. (*See*, *e.g.*, *CT Insider*, 12/21/22.) All told it is estimated that 85,400 units of affordable housing are needed. (*Ct Mirror*, 10/6/22.) No construction boom like that is on the horizon.

What then prevents or discourages developers from increasing the stock of affordable rental housing? The answer, as this Committee well knows, that the vast majority of the 169 towns, and particularly their zoning ordinances and zoning boards are stacked against the development of affordable houses. Whether it is the exclusionary zoning ordinances rampant in Fairfield County, or the real estate interests prevailing on zoning boards or the misplaced fears of residents that additional family housing will swamp schools with children who will put a strain on the Boards of Education budgets (and for other less savory reasons), towns are loath to situate new multifamily housing in areas of one family houses on large plots of land for fear of depressing prices (largely promulgated by real estate brokers). And they are loath permit such new developments in downtown areas for fear of "marring" or preventing the development of attractive shopping and dining areas and the businesses associated with them. I have seen such meetings throughout the state, and it is well known among developers and others in the real estate industry.

If you still have doubts about the malfunctioning of elementary school versions of supply-and-demand stories, let's look at what a major new out-of-state player in Connecticut's unregulated rent environment says. Up Realty, as we quoted them above, recommends to investors to bundle together their funds, not to create new housing stock, but rather to buy existing properties. "We think there is an unprecedented opportunity to acquire buildings now at 6-7 x the RR [Rental Revenue], put in the effort and refinance and get the money out." (Up Realty LLC Linked in Profile.) In other words, the high rents attract out-of-state capital not to invest in additional housing stock but rather to more efficiently extract the benefits (for landlords) from existing stock. We'll see how that process of turning rental property into financial products hurts not only tenants but the surrounding community and the state in general, below.

C. Uncontrolled Rent Increases Have Serious Consequences.

On a personal level, skyrocketing rental costs to young people, single parents, low wage workers and persons on fixed income is devastating. Even when homelessness is not the end result of unpredictable and unsupportable rent increases, home insecurity, fear and anxiety about the future (personally or for one's family) have costs. The toll that such stress exacts was dealt with extensively by the testimony last week not only by the victims but by social workers, politicians, doctors and social workers. Although the rent increases in Connecticut are more severe than the rest of the country, the housing crisis is national. I am sure that you all are aware of the letter sent by Congressman Jamaal Bowman and Senator Elizabeth Warren (co-signed by both Connecticut Senators and numerous others) to President Biden highlighting the rent crisis in this country. One source linked to that letter caught my attention by quoting the U.S. Government Accountability Office's finding that a median rent increase of $100 is associated with a 9% increase in homelessness. And not surprisingly from 2021 to 2022, Connecticut homelessness rose 13% from 2021 to 2022. (*Ct Mirror*, 10/6/22).

But I will limit myself here to the economic consequences.

When a market is distorted such as the case when demand exceeds supply, the sellers or service providers have a market power that allows them to extract surpra-competitive price, achieving profits in excess of historical trends and other industries. This is not the kind of market that classical economics contemplated when it describes the effects of market participants reaching optimal price unfettered by government interference. In fact, Adam Smith, who was after all a professor of moral philosophy, contemplated that as societies became wealthier wages would increase and profits decrease. He believed that markets ought to be shaped to prevent overwhelming power on one side. (*See*, *e.g.*, Deborah Boucoyannis, *The Equalizing Hand: Why Adam Smith Thought the Market Should Produce Wealth Without Steep Inequality* (Cambridge U Press, 2013).)

As a moral question, then, the question is: who should benefit from the potential excess rent that can be extracted from tenants. Landlords always claim that they are entitled to whatever benefit accrues to their one time wisdom of buying the building even if nothing they did put them in the position to reap the benefit flowing from inefficient government restrictions on construction. But looking at it that way, it is difficult to see that landlords are "entitled" to the oligopoly rents, at the expense of the tenants who paid the landlords in the expectation that they could make a home as long as in an implied bargain that both would treat the other fairly and eqauitably. It certainly would surprise the tenants and most outside observers if the government announced that tenants had to bear the risk of government regulations that created distorted markets, or the panic pricing caused by the fear or danger to their and their families of a disease that caused the landlords no real additional cost. But that is the case as long as in this state uncapped rent continues. But there are additional reasons.

We can already see the market distortions caused by restricted supply of affordable rental housing in Connecticut. Out-of-state capital is flooding this state because foreign investors, with no stake in the community or the welfare of Connecticut, can more ruthlessly exploit tenants. Let's again take the example of Up Realty LLC. Up Realty is a new breed of out-of-state capital designed to take advantage of the unregulated market here to acquire properties that promised unlimited benefits. Their stated plan is to use the funds collected in another foreign LLC to purchase an individual property, expel a number of tenants to "renovate" units, obtain refinancing from a bank and return the principal to the investors. Up Realty was then engaged as the general manager, and the nominal landlord and its members were able to take advantage of depreciation of their asset and passive income (over and above what the bank and Up Realty took) with absolutely no risk. Up Realty says that its "goal is to have most of the investor funds returned by 12-18 months. Making great return cash on cash for the percentage of money." In other words, investors have only a limited risk to their capital but expectation of long-term gain from unaccountable foreign limited liability manager.

This is how they accomplished this in the building for seniors in Middletown's Stonegate complex. After acquiring the property, Up Realty delivered "non renewal notices" to two dozen 62+ year old tenants in the midst of a global pandemic especially lethal to senior citizens (*see* *Middletown Press*, 8/25/20) in order to "to supervise these turn-round's [*sic*] and thereby quickly enhance the value of buildings under our ownership/management." (Up Realty.) Although this violated CSA 47A-23c, the rights of these senior tenants could be defended only in an eviction proceeding or by commencing and action in Superior Court, something that senior citizens, who had violated no law and had long been good tenants at Stonegate recoiled at, and therefore Up Realty reclaimed nearly all the apartments in order to add a veneer of remodeling to about a quarter of the units. The building was then, we presume, refinanced and now the landlord, who cannot be contacted by tenants, and its investors have no economic stake in the property. Up Realty, located in another city, makes upkeep and maintenance decisions without much contact with tenants. You can see how short of the mark they fall, while raising the rent of remaining senior citizens by over 20% in two years, and raising the new rent to the remodeled apartments by over 1/3. You can read of the experience of the tenants in this one property, which is the model for Up Realty's expansion throughout the state, in these written testimonies: 1., 2., 3., 4., 5., 6., 7. We could project how this approach will end – premature demise of the building because of lack of upkeep, destruction of community and a property that is a blight on the community, and a large rental property (170+ residential units) withdrawn from usable affordable housing. But we don't need to speculate because we can see the result of this "monetizing" of retail rental property by an out-of-state money, because Wedgewood Apartments in Bloomfield, Connecticut has already suffered this fate. This was one of Up Realty's early acquisitions. And its current condition has been reported by NBC Connecticut here and here, where you can see the results of the negligent management by Up Realty, including rodents, falling ceilings, neglected infrastructure and most surprisingly its arrogant decision to fail to attend a public hearing called on the subject.. If there were any doubt that this is the systematic behavior of Up Realty, you can see the complaints of Up Realty tenants across the state oin the Better Business Bureau.

I took this time to detail how out-of-state capital treats Connecticut real estate as investment property only and to show how this leads to problems not only to the tenants but to the community at large, Testimony last week shows that other large out-of-state managers act in similar ways almost with impunity. And for all the problems they cause, they are rewarded with legal unlimited rent increases, no cause evictions and the ability to charge new tenants as much as they can (not to mention tax and other government benefits).

D. How to Regulate the Out-of-Control Rent Increases.

The relevant provisions of HB 6588 and SB 4 originated in a bill submitted by Sen. Gary Winfield. In many ways that bill was more nuanced than the two bills remaining in committee. Winfield's bill would have eliminated many of the landlord complaints heard last week by exempting from its coverage apartments with a small number of units and by providing a hardship exemption for landlords if they could prove an extraordinary need for rent beyond the maximum in the bill.

Moreover, it fixed the increases at a level (2.5%) that would give meaningful relief to tenants and prevented the loophole contained in both HB 6588 and SB4 which would allow landlords to simply evict tenants and charge much higher rent for new tenants. That loophole removes the remain teeth in the pending bills.

The fault with the rent cap in the two bills – inflation plus four percent – is that it simply continues to allow landlords to extract supra-competitive profits from tenants (owing to the legislature's refusal to reign in abuses by local government zoning ordinances and the actions of zoning commission). No landlord last week presented any evidence that the skyrocketing rents were the result of increased variable spending. It is hardly believable that their expenses outpaced inflation.

In fact an index pegged to inflation allows landlords to continue to reap supra-competitive returns for two reasons. First, they have largely baked in the scarcity profits they extracted in the past three years from the pandemic and the inflation of last year. I heard no testimony last week that they are going to roll the increases back now or in the future. Each year from now on tenants will pay the excessive rent already imposed on them because of the unrestrained behavior of landlords in the last three years.

The second reason is that pegging inflation to the previous years' total rent grossly exaggerates the cost pressures on landlords even if they hadn't extracted above competitive rents. Rent is not related to inflation. In economic theory, rent is the payment for use of a capital asset. A landlord pays to build or buy a building and expects to be repaid over time with rent. It is an investment, not a speculation on the economy. The bulk of the rent goes to repay the purchase price and amortization of the property. **This is not in any respect increased by inflation**. Even if a landlord finances his purchase, assuming a fixed rate mortgage his financing charges are not affected by inflation.

It is true that in addition to amortizing the rental space, rent pays for maintenance and some other recurring expenses. But not only are these a small portion of the rent, in my experience with landlords those expenses are not closely related to inflation. I have not seen the salaries of maintenance workers rise with inflation. And in fact I have seen the reverse. Landlords have reduced maintenance costs (by slowing down the time for repairs and using cheaper parts or appliances).

Tacking rent increases to rate above inflation is unjustified. It in fact only makes inflation worse. No investor would consider rental real estate an inflation hedge unless he assumed that he could raise the rent above inflation. In other words the argument for tying to inflation is circular. And it's not justified as we have seen.

The best solution is to set the cap at a percentage of the existing rent. After all, the existing rent is paying for what the landlord sunk in the property. To pay for the small yearly increases in expense a rate of 2.5 – 4% should be enough to shield the landlord, and many of those opposing the bill have submitted was the normal rent increase before the pandemic. And even in that case it should be made clear that increases in that amount should be the outside amount allowed, with Fair Rent Commissions examining individual cases.

E. At Least One Loophole Must Be Closed.

For this scheme to work as designed, landlords cannot be allowed to evade it by giving them free reign to evict tenants without cause (except expiration of the lease). The law would be made a nullity if it could be evaded so easily. Connecticut law already prohibits no cause eviction in the case of residents 62 or older or those with physical or intellectual disabilities. CGA 47A-23c(a)(1). It would be simple drafting to extend that prohibition to cases involving all other tenants.